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No. 618

Supreme Court of the United States

OCTOBER TERM, 1949.

CONTINENTAL OIL COMPANY, a Delaware corporation,
~~Plaintiff~~, Petitioner,

VERSUS

H. C. JONES, COLLECTOR OF INTERNAL REVENUE,
~~Defendant~~. Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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February, 1950.

UTTERBACK TYPESETTING CO., 13 S. Walker, Oklahoma City 4, Okla.

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Plaintiff,

VERSUS

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Defendant.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED

This suit was brought by Group No. 2 Oil Corporation against H. C. Jones, Collector of Internal Revenue, for refund of overpayments of income taxes for 1940 and 1941, excess profits taxes for 1941, for interest paid on such taxes and for interest on the taxes and interest thus paid. After trial, but before judgment, Group No. 2 Oil Corporation was merged with Continental Oil Company, and the latter (petitioner here) was substituted as plaintiff. The cause was styled as above and numbered 3903 on the docket of the Court of Appeals.

The suit involved two disallowed deductions, one of

$218,047.15 representing unrecovered investments in certain surrendered oil and gas leases, a review of the decision on which is not sought; and the other of $57,328.68 representing loss on sale in 1941 of 250 shares of common stock of Reagan County Purchasing Company, Inc.* The Commissioner of Internal Revenue held there was no loss, but that the entire price received, $3,750.00, was profit, and made a net adjustment to income of $61,078.68 [R. 259, par. (f)].

Petitioner seeks hereby a review of the decision of the Court of Appeals [177 Fed. (2d) 508], which by affirming the District Court judgment sustained the disallowance of the loss and substitution of a gain on the sale of the Reagan stock. The overpayment sued for attributable to that item was $16,790.09, exclusive of interest (R. 260; Refund Claim, R. 330-333).

The taxpayer's true basis was $61,078.78 or $244.31+ per share. The facts as to the sale, the price received, and the basis were admitted in the answer (R. 27). The findings of the trial court were in accord (10 and 16, R. 36, 38).

The respondent defended on the ground that the shares sold were part of a block of 544 shares acquired by the taxpayer in its fiscal year ended March 31, 1927, of the value when received of $132,907.20 or $244.3147 per share; that the taxpayer had reported only $1.00 as the income represented thereby, and at the same time reported a loss of $39,133.37 on all its operations in the fiscal year; and, that since assessment of a deficiency for the fiscal year ending March 31, 1927, was barred by limitation, the taxpayer was estopped to claim the loss (Answer, R. 29). He urged that the same facts precluded a recovery under the

*Hereinafter referred to as "Reagan."

doctrine of "recoupment and/or set-off" (Amendment to Answer, R. 31).

In response, petitioner contended that:

(a) Sections 3770(a)(2) and 3775(a)* of the Internal Revenue Code preclude the Government from thus attempting to circumvent the applicable limitation statute.

(b) The Commissioner of Internal Revenue and his agents knew all the essential facts in time to have acted before assessment of the 1927 deficiency was barred.

(c) The taxpayer's failure to value properly the shares in its tax return for the fiscal year ending in 1927 was due to a mistake of law, the value of the shares not then having been determined, and its officers believing that they constituted income in 1924 when Reagan was organized and its stock was issued and had only a nominal value.

In 1924 Big Lake Oil Company, Texon Oil & Land Company, Group No. 1 Oil Corporation, and Group No. 2 Oil Corporation, the latter three being referred to as the "Texon Corporations", and the four of them being referred to as "Producers", and others, entered into a contract with Marland Oil Company to organize Reagan County Purchasing Company, Inc., and sell to it all oil that might be produced by the Producers in the Big Lake Field, or elsewhere in Reagan County, Texas. The contract provided for issuance of one-half of 49 per cent of the common stock in the names of the Texon Corporations, jointly, and one-half of 49 per cent in the name of Big Lake Oil Company, and that the certificates of stock should be placed in escrow to be held for the benefit of the Producers "in such number

*Revenue Act of 1928, Sections 607 and 609, respectively.

of shares or undivided interest in the whole number of shares" as should be agreed upon by them, until the preferred stock subscribed for by Marland should be retired. So long as any of the preferred stock was outstanding, no Producer was privileged to dispose of any of the common stock, except to Marland or another Producer, and that could be done only after the ultimate ownership of the 49 per cent was agreed upon (Plaintiff's Exhibit 9, R. 265-277).

On December 8, 1924, Reagan was organized and issued to the Texon Corporations, jointly, a certificate for 2,450 shares of common stock (R. 63), and to Big Lake a certificate for a like number of shares (Stip., R. 51-52). The certificates were deposited in escrow in the American National Bank of Oklahoma City (R. 286-295).

The conditions of the escrow were fulfilled by December 15, 1926, and the Producers agreed upon a division of the 49 per cent of the stock (R. 66-74). A certificate for 544 shares was then issued to Group No. 2 Oil Corporation on March 21, 1927 (R. 297).

At all times material to this controversy, the Texon Corporations were affiliated, occupied the same offices, and had the same directors, officers, managers and employees. These facts were well known to representatives of the Bureau of Internal Revenue (Revenue Agent's Reports: Group No. 1, R. 10-105; Texon of Texas, R. 80, 81; Texon of Delaware, R. 203).

In 1928 a revenue agent examined the records of all the Texon Corporations except Group No. 2 Oil Corpora-

tion (R. 220-222) and filed voluminous audit reports covering their fiscal year ending March 31, 1927, and prior years (Texon of Texas, Exhibit 1-E, R. 74, 95; Group No. 1, Exhibit 1-F, R. 96-123; Texon of Delaware, Exhibit "R", R. 199-204). The agent in charge proposed to recommend adjustments by including the Reagan shares in income for the fiscal year ending March 31, 1927, at $244.314698 per share (Texon of Texas, R. 74, 87-94), (Group No. 1 Oil Corporation, R. 96, 115-122).

Protests were filed (Exhibits 1-I and 1-J, R. 137, 141), assessment letters issued (R. 124-125, 132-133), and the tax was paid by Group No. 1 and Texon. Refund claims (R. 143-146) and supporting briefs were submitted (R. 150-153). They consistently contended that the income accrued in 1924 when the stock was issued and had no value. The refund claims were denied and litigation ensued. Texon's case was filed in the United States District Court at Fort Worth on December 12, 1938. Judgment was entered against it on October 18, 1939 (R. 182), and affirmed by the Circuit Court of Appeals (5th Cir.), on November 28, 1940 [115 Fed. (2d) 647].

Group No. 1 sued on its claim in the United States District Court at Fort Worth (R. 183-195). The printed record fails to show the filing date or disposition of the suit.* An assessment against Big Lake on the 2,450 shares it received was litigated and sustained [95 Fed. (2d) 573, *Cert.* den. 307 U. S. 639, rehearing den. 308 U. S. 632].

The complete documentary record on the stock issue was introduced in evidence for the purpose of showing that

*The controversy was compromised and the suit was dismissed.

the Producers which acquired interests in Reagan's stock at the time it was organized, and possession of certificates evidencing their divided interests in the year 1927, had what then appeared to be plausible grounds for resisting taxation of it in that year, and that their failure to report its true value in their 1927 returns resulted from a mistake of law; and, for the purpose of showing that the Commissioner of Internal Revenue and his agents in charge of collecting the tax knew all the facts concerning plaintiff's acquisition of its 544 shares long before limitations had barred an assessment.

The Commissioner of Internal Revenue, in his notice of deficiency (60-day letter) to Group No. 1, referred to the Revenue Agent's report for details of the Reagan stock acquisitions by the Producers, and made the report a part of his letter (R. 132, 137).

The trial court found that the 544 shares of Reagan stock of the value of $244.31 per share received by the taxpayer was income taxable in the fiscal year ending March 31, 1927 (Finding 10, R. 36); that it reported only $1.00 as the income represented thereby (Finding 11, R. 36), and, as a result, a net loss of $39,133.97 was shown on its return. It was further found, however, that the government agent, upon examination of the books and records of Texon and Group No. 1, "came into possession of knowledge * * * to the effect that plaintiff corporation had acquired the 544 shares of stock here involved at the same time and in the same manner as had said corporations" (*Id.* 12, R. 37).

Continuing, that Court found: "In the year 1928 the Commissioner of Internal Revenue did make an examina-

tion of the returns and books and records of plaintiff's affiliate corporations, Group No. 1 Oil Corporation and Texon Oil and Land Company. The report by these companies of the receipt of shares of Reagan County Purchasing Company stock at a nominal value of $1.00 was challenged by the Commissioner of Internal Revenue and its fair market value on receipt in 1927 determined at $244.00 per share, which was later affirmed by the Courts" (*Id.* 13, R. 37).

That Court conceded that the Commissioner was informed of the affairs of plaintiff through its return of income as filed by it and the knowledge gained by his agent in examining the records of the other corporations (*Id.* 15, R. 37), but, nevertheless, sustained the pleas of estoppel, recoupment, and setoff and denied relief (R. 40).

The Court of Appeals held that the taxpayer's mistake was not one of law, granted that it was true that the Commissioner learned the value of the Reagan stock through his examination of affiliated companies of the taxpayer, but held that he was not bound by knowledge thus gained. Disregarding applicable statutes and this Court's controlling decision in *McEachern* v. *Rose*, 302 U. S. 56, that Court declared the law to be as follows:

> "When a taxpayer received property, which constituted income to him, in a particular year and fixed the value of the property in his return for the year at less than its true value, and thereby avoided taxes, when he sells the property in a subsequent year, after the correction of the error in the return for the earlier year is barred by the statute of limitations, he may not fix the basis for determining gain or loss on

the sale at its true value and thereby obtain the benefit of a loss on the sale. He may not thus shift his position to his advantage, even though all the technical elements of estoppel are not present" (R. 345).

BASIS OF JURISDICTION

The Supreme Court has jurisdiction by *certiorari* to review the decision of the Court of Appeals in this action by virtue of the provisions of Title 28, United States Code, Section 1254(e).

Judgment was entered in the Court of Appeals on October 31, 1949 (R. 345), and a petition for rehearing filed November 19, 1949 (R. 347, 364), was denied on November 28, 1949 (R. 365). In compliance with the provisions of Title 28, United States Code, Section 2101(c), this petition is filed within ninety days thereafter.

QUESTIONS PRESENTED BY THIS PETITION

1. Whether the taxpayer, in computing gain or loss upon the sale of 250 shares of Reagan stock in 1941, was not entitled to use the correst basis of $244.31+ per share, but was bound to use a zero basis because of having reported a nominal value of $1.00 for its entire 544 shares on its return for the fiscal year ending March 31, 1927.

2. Whether, in view of the findings of the trial court that the revenue agent upon examination of the books and records of two of the taxpayer's affiliated corporations came into possession of knowledge that the taxpayer had ac-

quired its 544 shares of Reagan stock at the same time and in the same manner as had such affiliates, and that the Commissioner of Internal Revenue was informed to the same effect through the knowledge thus gained by his agent and the taxpayer's return (which showed receipt of the shares), the Court of Appeals erred in concluding, on the issue of estoppel, that the Commissioner was only charged with knowledge of facts reflected in the taxpayer's return or learned from an investigation of that return.

3. Whether the Court of Appeals erred in holding that the taxpayer's mistake in not returning the Reagan shares at their true value in 1927, was not a mistake of law rather than of fact.

4. Whether, in any event, the distinction between a taxpayer's mistake of law and a mistake of fact is of any consequence in applying the doctrine of *McEachern* v. *Rose* (302 U. S. 56), to the effect that Sections 3770(a)(2) and 3775(a) of the Internal Revenue Code preclude the Government from taking any benefit from a taxpayer's overpayment by crediting it against an unpaid tax whose collection is barred by limitation.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. On the question of availability of estoppel, recoupment and setoff as defenses, the decision of the Court of Appeals is in conflict with,

(1) the decision of the Supreme Court in *McEachern* v. *Rose*, 302 U. S. 56;

(2) the decision of the Circuit Court of Appeals in *American Light & Traction Co.* v. *Harrison*, 142 Fed. (2d) 639 (7th Cir., 1944);

(3) the decision of the Circuit Court of Appeals in *Salvage* v. *Commissioner*, 76 Fed. (2d) 112 (2nd Cir., 1935); and the decision of the Supreme Court in the same case, *Helvering* v. *Salvage*, 297 U. S. 106; and,

(4) the decision of the Circuit Court of Appeals in *Schmidlapp* v. *Commissioner*, 96 Fed. (2d) 680 (2nd Cir., 1938).

2. On the question of whether the Commissioner was bound by knowledge gained from sources other than the taxpayer's returns and records, the decision of the Court of Appeals is in conflict with

(1) the decision of the Court of Appeals in *Ross* v. *Commissioner*, 169 Fed. (2d) 483, 495 (1st Cir., 1948); and,

(2) the decision of the Circuit Court of Appeals in *Joyce* v. *Gentsch*, 141 Fed. (2d) 891 (6th Cir., 1944).

3. On the issue of estoppel the Court of Appeals adhered to its own decisions in *Commissioner* v. *Farren*, 82 Fed. (2d) 141, 143 (1936), and prior cases, although *certiorari* was granted in the *Farren* case May 25, 1936 (298 U. S. 653), and was dismissed, *per stipulation of Counsel*, on October 26, 1936 (299 U. S. 617). The same reasons which impelled the granting of the writ in that case are present here.

WHEREFORE, petitioner prays that a *writ of certiorari* issue to review the decision of the Court of Appeals in this cause.

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BRIEF IN SUPPORT OF PETITION

OPINION BELOW

The opinion of the Court of Appeals is reported in 177 Fed. (2d) 508.

JURISDICTION

The grounds on which Jurisdiction of this Court is invoked are stated on page 8 of the Petition.

STATEMENT OF THE CASE

The facts have been outlined in the petition under the head of "Summary and Short Statement of the Matter Involved."

STATUTES INVOLVED

The statutes involved are copied in the appendix.

They are: Internal Revenue Code, Sections 275(a), 3770(a)(2), and 3775(a).

ASSIGNMENTS OF ERROR

1. The decision of the Court of Appeals is erroneous and in conflict with the decisions of this Court and of other courts of appeal on the question of estoppel, recoupment or setoff as a defense.

2. The decision of the Court of Appeals is erroneous and in conflict with the decisions of other courts of appeal on the question of the binding effect on the Commissioner of Internal Revenue of knowledge gained from sources other than the taxpayer's return and records.

ARGUMENT

(1).

In *McEachern* v. *Rose,* 302 U. S. 56, the taxpayer's decedent had sold shares of corporate stock in 1924 at a profit of $295,000.00, payable in ten equal annual installments. After his death in 1928, the taxpayer (administrator) continued from 1929 to 1931 to pay income tax on the installments, whereas he should have reported for 1928 the capital gain included in the value of the unpaid installments at the time of the decedent's death. This Court said that the "returns were erroneous in point of fact and law, as the petitioner sold no shares of stock in any of those years." After assessment of the tax for 1928 was barred, the taxpayer sought to recover the overpayments for 1929 to 1931, inclusive. The Government contended that he was estopped, since the overpayments were less than the tax which should have been assessed in 1928. The Supreme Court assumed that equitable principles would have precluded a recovery in the absence of any statutory provision requiring a different result, but concluded that Congress has set limits to the extent to which courts might otherwise go in curtailing a recovery of overpayments because of a taxpayer's failure to pay other taxes which might have been, but were not, assessed against him, and that Sections 607 and 609(a), Revenue Act of 1928, preclude the Govern-

ment from taking any benefit from a taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation. 302 U. S. 59, 60.

In *American Light & Traction Co.* v. *Harrison,* 142 Fed. (2d) 639 (7th Cir., 1944), a subsidiary of the taxpayer, in an exchange of common stock of another corporation for debentures of still another corporation, realized a taxable profit of $2,851,504.00, which the taxpayer, in its consolidated return for 1928, did not report because it believed the transaction was tax-free. The law was later settled to the contrary. During the years 1930 and 1931, the subsidiary sold some of the debentures at their face value. Hence no gain was realized thereon. In 1933 it sold the rest, and the taxpayer erroneously included in its consolidated return taxable income on account of the last sale in the sum of $1,731,403.76. It sought a refund, which was rejected, and suit was brought against the collector. The collector contended that he was entitled in equity to recoup against the taxpayer's claim for overpayment in 1933 the taxes which should have been paid on the subsidiary's profits on the exchange of stock for debentures in 1928. The Circuit Court of Appeals said:

> "Section 607 of the Revenue Act of 1928, 45 Stat. 791, 874, 26 U. S. C. A. Int. Rev. Code, §3770(a) (2), which is significantly entitled 'Effect of Expiration of Period of Limitation Against United States,' provides that any payment of a tax after the expiration of the applicable period of limitation shall be considered an overpayment and directs that it be '* * * credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim.' Under this section, any payment of the barred de-

> ficiency for 1928 would constitute an overpayment, the refund of which would be mandatory. Section 609(a) provides that 'Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under Section 607.' 45 Stat. 875, 26 U. S. C. A. Int. Rev. Code, §3775(a). Since the payment of the barred deficiency for 1928 would constitute an overpayment under §607, it necessarily follows that any credit of the 1933 overpayment against the barred deficiency would be void under §609(a). In the light of these provisions, the only possible conclusion is to affirm the District Court's judgment for the plaintiff. Any other result would effect a judicial repeal of the Act of Congress."

In *Salvage* v. *Commissioner,* (2nd Cir., 1935), 76 Fed. (2d) 112, the taxpayer purchased stock in 1922 at a bargain and failed to report as income the profit represented by the difference between the price paid and the value of the stock. In computing his gain on the sale of the stock in 1929 he used the correct basis, *i. e.*, the value of the stock when it was acquired. The statute of limitations had run on collection of the tax that would have been due for 1922 had the profit been reported. The Commissioner pleaded estoppel. The Circuit Court of Appeals sustained the taxpayer's right to use the true basis of the shares upon the sale of them. This Court affirmed the decision holding that the issue of estoppel was not raised and should not have been passed upon by the court below, but, further, that "*the facts disclosed give it no support.*"

In *Schmidlapp* v. *Commissioner* (2nd Cir., 1938), 96 Fed. (2d) 680, the taxpayer, in 1929, sold certain shares of stock, which he had bought at various times, at a profit

which he did not report in his return for that year, on the theory that he would use proceeds of first sales to amortize the entire purchase price and treat proceeds of later sales as profit. In 1932 he sold his remaining shares and followed the same method, that is, he subtracted the proceeds of the 1932 sales from what was left unamortized of the original purchase price and deducted the balance as a loss. The Commissioner, for other reasons, disallowed his entire deduction, but the Board reversed and reinstated the deduction, though only for the amount claimed. A deficiency resulted which the taxpayer could expunge only if allowed to calculate his loss for 1932 by the "first in, first out" method. Had he applied that method in 1929, a taxable gain would have resulted nearly as great as the deduction claimed. It was too late to assess any tax for 1929. It was contended that he could not disavow his first choice as to the method of calculating gain or loss and altogether avoid a tax which in 1929 he professed only to defer. The Circuit Court granted there was much justice in the argument, and that it would have been particularly strong if the taxpayer had been seeking to get back what he had paid, but concluded:

> "Yet even then, *McEachern* v. *Rose,* 302 U. S. 56, would stand in the way, since under section 609(a) of Revenue Act of 1928, the credit of any sums due in the later year would be 'void' against an assessment, payment of which would have to be refunded under section 607 of the Revenue Act of 1928. * * * The doctrines of a court of equity are irrelevant to the levying of taxes; Congress alone lays down the conditions and has not attempted to bring other years into hotch-pot. Quite other considerations decide

whether a sum, once paid as a tax, shall be recovered; the mere payment creates no obligation to return it, the taxpayer makes it at the peril of showing that in common justice it ought not to be retained. *Farren* v. *Commissioner,* 10 Cir., 82 Fed. 2d 141, is not to the contrary; it only held that, since the taxpayers failed to prove the cost of the shares sold, they must be content to have the whole proceeds taxed as profit. On the other hand, *Salvage* v. *Helvering,* 2 Cir., 76 F. 2d 112; *Id.,* 297 U. S. 106, 56 S. Ct. 375, 80 L. Ed. 511, cannot be reconciled with the notion that the validity of a deduction in a later year shall be measured by recourse to the assessments of earlier years."

The problem of allocating income to the right year in cases involving escrows or conditional deliveries is rarely an easy one. The taxpayer and other producers which held the Reagan stock are not to be censured, therefore, for having guessed wrong in contending that it constituted income in 1924, when it had only a nominal value, and not in 1927, when it had greatly enhanced in value. And, too, since they had paid nothing for the stock, their position was similar to that of the taxpayer in the *Salvage* case who failed to report the profit on a bargain purchase. It is submitted that the error was not a mistake of fact but merely one of law.

It is to be remembered that the taxpayer, as well as its affiliates, did nothing to conceal receipt of the income; that they reported receipt of the shares in their 1927 returns.

The Commissioner had the taxpayer's 1927 return and, as found by the trial court, he learned that it had received the stock entered thereon at the same time and in the same

manner as the taxpayer's affiliates had received their shares, which were the subject of audits and assessments in 1928, and ultimately of suits. He knew of the circumstances in time to have taken appropriate action against the taxpayer before assessment of the 1927 tax was barred. These facts and findings of the trial court the Court of Appeals should have accepted as binding on it, but that court, nevertheless, recognized that "all the technical elements of estoppel are not present" (R. 345, line 10).

If "all the elements of estoppel are not present", then there is no estoppel, and characterizing the absent element as "technical" does not create one. The Court of Appeals, without classifying the theory it applied, stated in its conclusion quoted at pages 7-8 of the petition a doubtful case for application of the doctrines of recoupment or setoff, even in the absence of the statutes which were held to be controlling in *McEachern* v. *Rose, American Light and Traction Co.* v. *Harrison,* and *Schmidlapp* v. *Commissioner, supra.*

(2).

JUSTICE FRANKFURTER'S opinion in *Ross* v. *Commissioner of Internal Revenue* (1st Cir., 1948), 169 Fed. (2d) 483, covers every phase of the controversy presented by this petition. Among the questions discussed was the point raised by the Commissioner that the taxpayer had failed to report income (salary installments constructively received) in the years received. The evidence showed, though less clearly than here, that the Commissioner knew, or should have known, the facts from other sources, particularly the books and records of the taxpayer's employer.

The Court granted that where a party is under a duty to disclose the existence of a fact and does not do so, his silence amounts to a statement that the fact does not exist, and referred to the cases so holding; but it then continued as follows:

> "They do not qualify the proposition that a party may not successfully claim reliance on a misrepresentation when he knew the truth, nor probably even when he ought to have known the truth. *Joyce* v. *Gentsch*, 6 Cir., 1944, 141 F. 2d 891; *Helvering* v. *Schine Chain Theatres, Inc.*, 2 Cir., 1941, 121 F. 2d 948; *S. Rossin & Sons, Inc.* v. *Commissioner*, 2 Cir., 1940, 113 F. 2d 652; *Hull* v. *Commissioner*, 4 Cir., 1937, 87 F. 2d 260; *Helvering* v. *Brooklyn City R. Co.*, 2 Cir., 1934, 72 F. 2d 274; see 10 Mertens, *supra*, §60.03. In the *Brooklyn City R. Co.* case, the Commissioner's claim of estoppel was defeated because the facts which he claimed to be misrepresented were available at all times on the books of the taxpayer. The record before us contains several references to the likelihood that respondent knew, or should have known, the true facts surrounding the accrual of petitioner's salaries and the unrestricted availability of these salaries after April, 1932. For example, in 1935 the Commissioner began to contest Chase's tax treatment of accrued salaries for 1932 and 1933, and thus apparently learned of the facts in question before the taxable year 1932 was barred as to Ross. Moreover, E. M. Chase Company always deducted the entire amount of the salaries of Chase and Ross on its corporate return, and the discrepancy between the individual returns and the corporate return was always evident, whether or not it registered on the official consciousness. And, as in the *Brooklyn City R. Co.* case, the accrued salary accounts of Chase and Ross were always disclosed on the financial statements of the company. A letter

from the Internal Revenue Service to the company, dated December 29, 1933, shows indisputably that respondent knew of the accrued salaries and of petitioner's tax treatment of them. This letter, written when the taxable year 1932 was still open, reveals full knowledge on the part of respondent of the operations of the company, including the gradual retirement of Chase's preferred stock. Under these circumstances respondent was justified in relying on Ross' returns for no more than the taxpayer's honest understanding of his liabilities, and it was respondent's duty to make up his own mind as to the taxability of the accrued salaries. *Joyce* v. *Gentsch, supra; Commissioner* v. *Saltonstall*, 1 Cir., 1941, 124 F. 2d 110; *Helvering* v. *Schine Chain Theatres, Inc., supra.*

* * * * * * * *

"(20) A mere failure to report income is not a representation that such income has in fact not been received. Inasmuch as the tax incidence of so many transactions is as doubtful as it is, from the mere failure to report income no more significant inference should be drawn than *the taxpayer's own interpretation of the law.* And it seems settled that estoppel cannot be predicated upon a mere statement of law or silence resulting from an error of law. *Commissioner* v. *American Light & Traction Co.*, 7 Cir., 1942, 125 F. 2d 365; *Commissioner* v. *Union Pacific R. Co.*, 2 Cir., 1936, 86 F. 2d 637; *United States* v. *Du Pont*, D. C. Del., 1942, 47 F. Supp. 894; *Sugar Creek Coal & Mining Co.*, 1934, 31 B. T. A. 344; *Tide Water Oil Company*, 1934, 29 B. T. A. 1208 (1934).

"(21) Of course this court may not make findings as to the existence or lack of existence of facts sufficient to raise an estoppel. But even if the Tax Court on reconsideration of this case should find in the record justifiable reliance by the respondent on the

petitioner's returns, it is our view that *in the absence of either deliberate or unintentional misrepresentation of facts there can be no estoppel.* It may be noted that if we were to hold that mere failure to report income results in estoppel and therefore in effect tolls the statute of limitations, we would be rendering virtually meaningless §275(c) of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, §275(c), which provides, 'If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed * * * at any time within 5 years after the return was filed' " (pp. 495, 496).

Although the facts are not similar, the principles declared in the decision of *Joyce* v. *Gentsch* (6th Cir., 1944), 141 Fed. (2d) 891, are applicable here. There, after a settlement of taxpayer's liabilities for 1934 had been accepted by the Government without a formal closing agreement, the taxpayer filed a claim for the same year because of his failure to deduct a loss on certain corporate stock which had become worthless in that year. He had claimed the same loss in 1935, but withdrew that claim when he filed his 1934 claim. The Government had determined that the stock became worthless in 1937. When the claim for refund was filed, further assessments for 1934 were barred. The Circuit Court of Appeals, as well as the District Court, noted the practical difficulty of determining when, for income tax purposes, stocks have become worthless (p. 894, col. 1). After pointing out that for a sufficient time before the statute of limitations had run, the Commissioner possessed all essential information as to the affairs of the corporations which had issued the stocks upon which to

base an opinion as to when the stocks became worthless, the Circuit Court of Appeals continued:

> "In these circumstances, if he allowed the statute of limitations to run without taking appropriate action upon the strength of the information which he possessed, it is now too late for him to complain. See *Louis Werner Saw Mill Co.* v. *Helvering*, 68 App. D. C. 267, 96 F. 2d 539, 543, *supra*. As was well said in *Hull* v. *Commissioner of Internal Revenue*, 4 Cir., 87 F. 2d 260, 262, *supra*: 'Estoppel is an affirmative defense, and the burden is upon the party asserting it to establish both the facts necessary to support it and the fairness of its application, and a party even knowing the facts, or in a position to know them, cannot claim the benefit of estoppel.' It was noted in *Helvering* v. *Schine Chain Theatres, Inc.*, 2 Cir., 121 F. 2d 948, 950, *supra*, that if all the facts were available to the Commissioner, he was justified in relying upon the tax return for no more than the taxpayer's 'honest understanding of his liabilities,' and that if the Commissioner 'wished to avoid the running of the statute, he must make up his mind for himself' " (pp. 896, 897).

CONCLUSION

If the decision below is permitted to stand, it will create confusion on the issue of estoppel as a defense in tax cases. Unless its error is corrected, the Court of Appeals for the Tenth Circuit may be expected to follow its own decision in the *Farren* case, which nowhere else, except perhaps in the Fifth Circuit, is recognized as correct.

On the question of the binding effect on the Commissioner of knowledge gained by him from sources other than

the taxpayer's own return and records, the conflict between the decision in the case at bar and that of the Court of Appeals for the First Circuit in *Ross* v. *Commissioner* is obvious. CHIEF JUDGE PHILLIPS, speaking for the Court of Appeals in the Tenth Circuit, asserts that the Commissioner is not bound by knowledge thus gained. JUSTICE FRANKFURTER, speaking as Circuit Justice in the *Ross* case, said just as emphatically that the Commissioner *is* bound by knowledge thus gained. It is therefore urged that this Petition for Certiorari should be granted.

Respectfully submitted,

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February, 1950.

APPENDIX

INTERNAL REVENUE CODE SECTIONS

Section 275. *Period of limitation upon assessment and collection.*

(a) *General rule.* The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Section 3770. *Authority to make abatements, credits, and refunds.*

(a) *To taxpayers*

* * * * * * * *

(2) *Assessments and collections after limitation period.* Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim.[1]

Section 3775. *Credits after periods of limitation.*

(a) *Period against United States.* Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under Section 3770(a) (2).[2]

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[1]From Sec. 607 Revenue Act 1928.

[2]From Sec. 609 Revenue Act 1928.